STATE OF CALIFORNIA GRAY DAVIS, *Governor*

PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

October 30, 2001

Item 5
11/8/2001

TO: PARTIES OF RECORD IN APPLICATION (A.) 00-10-045 AND A.01-01-044

This is the draft decision of Administrative Law Judge (ALJ) Wetzell. It will be on the Commission's agenda at the meeting on November 8, 2001. The Commission may act then, or it may postpone action until later.

When the Commission acts on the draft decision, it may adopt all or part of it as written, amend or modify it, or set it aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

Pursuant to Rule 77.7(f)(9), comments on the draft decision must be filed on or before November 5, 2001. Reply comments will not be accepted.

In addition to service by mail, parties should send comments in electronic form to those appearances and the state service list that provided an electronic mail address to the Commission, including ALJ Wetzell at msw@cpuc.ca.gov. Finally, comments must be served separately on the Assigned Commissioner, and for that purpose I suggest hand delivery, overnight mail, or other expeditious methods of service.

/s/ LYNN T. CAREW
Lynn T. Carew, Chief
Administrative Law Judge

MSW:avs

Attachments

Decision **DRAFT DECISION OF ALJ WETZELL (Mailed 10/30/2001)**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of San Diego Gas & Electric Company (U 902-E) for an Order Implementing Assembly Bill 265.	Application 00-10-045 (Filed October 24, 2000)
Application of San Diego Gas & Electric Company (U 902-E) for Authority to Implement an Electric Rate Surcharge to Manage the Balance in the Energy Rate Ceiling Revenue Shortfall Account.	Application 01-01-044 (Filed January 24, 2001)

OPINION ADOPTING AN INTERIM COST RECOVERY MECHANISM FOR UTILITY-RETAINED GENERATION

1. Summary

On June 18, 2001, San Diego Gas & Electric Company (SDG&E), its parent company Sempra Energy, and the Department of Water Resources (DWR) entered into a Memorandum of Understanding (MOU) regarding the provision of electricity to SDG&E's customers.[1] By motion filed in this consolidated proceeding on July 16, 2001, SDG&E requests that the Commission issue several "Implementing Decisions" related to the MOU. This decision responds to one aspect of the motion, i.e., SDG&E's request that the Commission adopt a

[1] Sempra Energy entered into the MOU only as to certain sections thereof. DWR entered into the MOU separately and apart from its powers and responsibilities with respect to the State Water Resources Development System.

utility-retained generation (URG) cost recovery mechanism that "… ensures that SDG&E collects revenue sufficient to cover its costs associated with its URG."[2] (July 16 Motion, p. 7, Item c.) This decision does not resolve implementation of the MOU as a whole.

We establish, on an interim basis pending a decision on an application that we direct SDG&E to file, a URG cost recovery mechanism that draws on the former Energy Cost Adjustment Clause (ECAC) balancing account mechanism for fuel and related costs. To the extent that SDG&E requests that we provide for assured, complete recovery of its incurred URG costs without meaningful opportunity for this Commission to determine whether costs that are passed on to ratepayers are reasonably incurred, such request is denied. We will, however, allow SDG&E to make a proposal for a URG cost recovery mechanism that includes a provision for eliminating traditional after-the-fact reasonableness reviews provided that such mechanism reasonably assures that ratepayers are protected against paying for unreasonable costs.

2. Procedural Background

By ruling issued on July 23, 2001, interested parties were allowed to file comments on SDG&E's July 16 motion for implementation of the MOU. Parties were directed to file such comments by July 27, 2001. Comments were filed by the Office of Ratepayer Advocates (ORA), the Department of the Navy on behalf of itself and all Federal Executive Agencies (FEA), the California Farm Bureau Federation (CFBF), and jointly by the Utility Consumers' Action Network

[2] SDG&E defines its URG as its generation assets and all energy, capacity, ancillary services, and any combination thereof, to which SDG&E has a contractual right.

(UCAN), Aglet Consumer Alliance (Aglet), and The Utility Reform Network (TURN).

An Assigned Commissioner's Ruling (ACR) issued on August 2, 2001 established a schedule that would allow the Commission to consider the individual components of the MOU as quickly as reasonably practicable, and in any event prior to the end of the year. The ruling also set an oral argument, held in San Diego on August 16, 2001, to address the merits of the MOU. A public participation hearing on the MOU was held on the same day. This decision is issued pursuant to the August 2, ruling, and is based on the July 16 motion, the comments filed pursuant to the July 23 ruling, and the August 16 oral argument and public participation hearing.

On October 10, 2001 ORA, FEA, CFBF, Aglet, TURN, and UCAN (collectively, Consumers) filed a motion for adoption of a stipulation joined by each of them. The Consumers' stipulation is presented as a means of resolving several ratemaking issues before the Commission and represents an alternative to the MOU. This decision does not address the Consumers' stipulation, which remains pending before the Commission while its status is resolved.

3. The Need for a URG Cost Recovery Mechanism

SDG&E states that its proposed URG mechanism is offered in consideration of its commitment of its URG to cost-based ratemaking for SDG&E's bundled service customers,[3] and its commitment not to seek authority

[3] SDG&E believes that its URG should be allocated entirely to "AB 265 customers," *i.e.*, residential, small commercial, and street lighting customers. However, in D.01-09-059 we decided to continue with our usual practice of applying URG to all customer classes, and we do not revisit this issue here. We understand SDG&E's reference to bundled service customers to mean all electric customers, regardless of size or assigned tariff

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to sell such assets through December 31, 2010.[4] However, with respect to utility-owned generation assets through the year 2005, there is another and more compelling consideration that leads us to conclude that we should adopt a ratemaking mechanism for SDG&E's URG. Pub. Util. Code § 377, as amended by Assembly Bill (AB) 6 of the first Extraordinary Session of 2001 (Stats. 2001, Ch. 2; hereinafter, referred to as ABX1 6), requires the following:

> The commission shall continue to regulate the facilities for the generation of electricity owned by any public utility prior to January 1, 1997, that are subject to commission regulation until the owner of those facilities has applied to the commission to dispose of those facilities and has been authorized by the commission under Section 851 to undertake that disposal. Notwithstanding any other provision of law, no facility for the generation of electricity owned by a public utility may be disposed of prior to January 1, 2006. The commission shall ensure that public utility generation assets remain dedicated to service for the benefit of California ratepayers.

In view of the foregoing, and in particular the requirement of § 377 that we "shall ensure that public utility generation assets remain dedicated to service for

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schedule, that do not take direct access service. Bundled service customers are not synonymous with AB 265 customers.

[4] SDG&E states that these URG commitments are subject to adoption of certain Implementing Decisions described in the MOU: (a) Commission approval of the SDG&E/ORA settlement of the procurement reasonableness review in A.00-10-008; (b) Commission execution of a settlement of claims in SDG&E's Writ of Review regarding certain intermediate-term contracts; (c) Commission approval of the proposed URG cost recovery mechanism; and (d) Commission approval of SDG&E's petition for modification in A.93-12-025/I.94-02-002 in which SDG&E requests approval of the MOU's provisions with respect to its interest in the San Onofre Nuclear Generating Station (SONGS). We wish to emphasize that to the extent that SDG&E's

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the benefit of California ratepayers," it is incumbent upon the Commission to provide for SDG&E's continued ability to dedicate and operate its URG to service for ratepayers' benefit. This in turn requires that we establish an appropriate ratemaking mechanism with respect to SDG&E's URG.

However, we are not prepared to fully embrace SDG&E's proposal at this time. As several parties have pointed out, there has not been an adequate opportunity in this proceeding for full and fair consideration of SDG&E's proposed URG cost recovery mechanism or possible alternative mechanisms. Among other things, we believe it is necessary to more closely coordinate development of the mechanism for SDG&E's URG cost recovery with current, related proceedings regarding SDG&E's interest in SONGS (A.93-12-025/I.94-02-002), SDG&E's URG revenue requirement (A.00-11-038, et al.), and our rulemaking proceeding for cost recovery for procurement of net short energy requirements (R.01-10-024).

SDG&E contends that its proposal for assured, complete URG cost recovery is justified in view of its commitments (1) to provide its URG under cost-based ratemaking to its bundled service customers and (2) to not seek authority to sell such assets through December 31, 2010. SDG&E asserts that these URG commitments represent a substantial and valuable benefit to its customers that justifies the particular cost recovery plan it has proposed. Again, there has not been adequate opportunity to consider the value to ratepayers of SDG&E's URG commitments, or to weigh such value against particular program elements proposed by SDG&E that may not benefit ratepayers. Thus, on the limited record before us, we cannot accept SDG&E's proposition that "[i]t is

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URG commitments are already mandated as a matter of law, SDG&E cannot make such commitments conditional, subject to decisions that it has asked us to make.

clearly reasonable for SDG&E, in exchange [for its URG commitments], to be entitled to collect revenues from its customers sufficient to recover completely all its costs associated with that committed URG."

As indicated earlier, this decision does not consider the MOU as a whole. Accordingly, for purposes of this decision, we explicitly do not accept SDG&E's assertion that ratepayer benefits are "enhanced greatly" by the fact that approval of SDG&E's proposal for URG cost recovery would satisfy one of the MOU's several provisions for Implementing Decisions.

Under these circumstances, we find that it is appropriate both to provide a forum for full and fair consideration of a URG cost recovery mechanism and to establish an interim mechanism at this time. For purposes of an interim mechanism, we draw upon the elements of SDG&E's proposal that we find to be reasonable and appropriate, as discussed in Section 4 of this decision.

We direct SDG&E to file an application for a more permanent URG cost recovery mechanism that would continue, modify, or replace the interim mechanism adopted today. SDG&E should file this application within 60 days of the date of this decision. The application will provide SDG&E an opportunity to better explain, update, and refine its URG cost recovery proposal in light of the concerns we discuss herein as well as the latest developments in the unsettled electric industry. It will also provide all parties an opportunity to review SDG&E's proposal and offer for our consideration alternative proposals for URG cost recovery. SDG&E's application should demonstrate how its proposed URG mechanism interacts with its net short cost recovery mechanism. We intend to process this application within 12 months, and that the interim mechanism that we approve today will remain in effect until not later than December 31, 2002.

4. Interim URG Cost Recovery Mechanism

4.1 Objectives for the Mechanism

SDG&E's stated objectives for its URG cost recovery mechanism are to ensure its ability to collect revenues sufficient to recover its URG costs on a timely basis, in accordance with the principles of cost-based ratemaking as applied in California; to ensure timely reconciliation of any undercollection or overcollection of its URG costs; and to ensure that any undercollection can be financed in the capital or credit markets on reasonable terms consistent with SDG&E continuing to be an investment grade credit. For purposes of the interim cost recovery mechanism adopted today, we generally concur with these utility objectives, with the caveat that "principles of cost-based ratemaking as applied in California" include the proposition that while utilities are entitled to reasonable opportunity for cost recovery in accordance with applicable state and federal law, they are generally not entitled to guaranteed, dollar-for-dollar recovery of all costs incurred in the provision of utility service without regard to the reasonableness of such costs. Our own objectives also include ensuring that adequate utility service is provided at reasonable rates.

The interim ratemaking mechanism we adopt today is applicable to SDG&E only, and has no precedential effect with respect to the other utilities that we regulate. Also, this mechanism is intended for prospective URG costs, and not for past under-collections unrelated to URG.

4.2 Scope of SDG&E's URG

SDG&E proposes that for purposes of the URG cost recovery mechanism, its URG would consist of the company's interest in SONGS, a SONGS equalization adjustment proposed in the MOU, Qualifying Facility (QF) contract costs, Portland General Electric contract costs, other long-term bilateral

power purchase contract costs, and ancillary and ISO charges that are not assumed by the DWR. SDG&E also proposes that its subject URG costs would include any undercollected amounts recorded in the Transition Cost Balancing Account (TCBA) that would result if URG costs were above the 6.5 cents per kilowatt-hour (kWh) rate that SDG&E currently charges it customers for URG. SDG&E proposes to exclude two intermediate-term power purchase contracts that expire at the end of 2001 (which contracts are the subject of another of the requested Implementing Decisions described in the MOU), and any options, swaps or other contractual arrangements with third parties relating to the delivery of electricity under said intermediate-term contracts that are entered into in order to change the ultimate point of delivery to South of Path 15 or any other point or points of delivery to which the parties thereto may mutually agree.

SDG&E's proposal for the definition and scope of its URG appears to be consistent with URG revenue requirement testimony it has presented in the URG phase of A.00-11-038, et al. Since the two intermediate-term contracts referenced by SDG&E expire at the end of this year, it is appropriate to exclude them from the cost recovery mechanism as proposed by SDG&E. For purposes of an interim URG cost recovery mechanism, and except for the proposed SONGS equalization adjustment, we adopt SDG&E's proposed definition and scope of URG.[5]

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[5] While we allow SDG&E to include any recorded TCBA undercollection that may result from any URG costs above the 6.5 cents per kWh energy rate component, we do not by this decision waive our right to review the reasonableness of such costs (to the extent such costs have not otherwise been considered by the Commission). Also, we do not by this decision prejudge our decision on SDG&E's proposals in A.93-12-025/I.94 02-002 with respect to its interest in SONGS, including the proposed SONGS equalization adjustment. The proposed SONGS equalization adjustment will

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We note that for purposes of a permanent URG cost recovery mechanism, it will be necessary to adopt a more rigorous definition of SDG&E's URG. This is because SDG&E defines URG to include all energy, capacity, ancillary services, and any combination thereof, to which SDG&E has a contractual right. If SDG&E enters into a contract for energy, capacity, ancillary services, or any combination thereof with respect to its net short position, such contract would fall within the company's definition of URG. Depending on the mechanism we adopt for cost recovery for procurement related to the net short position, this could result in uncertainty regarding the appropriate cost recovery mechanism.

4.3 Annual Filings

SDG&E proposes to file annual forecasts of its URG costs on October 1 of each year. Each annual forecast would be for the twelve-month period commencing on January 1 of the subsequent year. The forecast would include the anticipated SONGS and contractual revenue requirements, plus the ancillary and ISO charges expected to be paid by SDG&E, as well as the forecasted sales over which these costs will be recovered.

SDG&E's proposal is incomplete in that it does not state what form the annual filing would take, *i.e.*, application or advice letter, and it does not state the process that would be undertaken by the Commission to review and implement the filing. We note that since the filing would occur just three months before rate changes would take effect, there would not be adequate time for the Commission to resolve a contested application.

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be included in the URG cost recovery mechanism only if a decision in that proceeding provides for such inclusion.

Since we are adopting an interim cost recovery mechanism at this time, we need not determine the procedure to be followed for periodic updates. For purposes of the interim mechanism, we direct SDG&E to file an application setting forth its forecast of URG costs for the 2002 forecast period described in the following section. This application should be filed not later than 15 days after the later of issuance of a decision on its URG costs in the URG phase of A.00-11-038, et al., or issuance of a decision on SONGS rulemaking in A.93-12-025 et al.

4.4 Effective Period

SDG&E proposes that rates be set effective on each January 1 to recover the adopted forecast revenue requirement over the next 12 months. For example, on October 1, 2001 SDG&E would file for recovery of URG costs for the forecasted period January 1, 2002 through December 31, 2002, and rates would change on January 1, 2002 to effect such recovery.

For purposes of the interim mechanism, rate adjustments that might be justified will become effective on the date we specify in our decision on the 2002 URG forecast application, described above. While we will process this application on an expedited schedule, it likely will not be possible to issue a decision prior to January 1, 2002 for implementation of rate changes on that date. SDG&E's 2002 forecast application shall designate the forecast period, which shall begin as soon as practicable after the decision on said application. Due to uncertainty regarding the processing time for the application it may be appropriate for SDG&E's application to designate alternative forecast periods.

4.5 Balancing Account

SDG&E proposes that a balancing account be established to record costs and revenues associated with the URG costs and rate revenues. The

balancing account would be called the Utility Retained Generation Cost Adjustment Mechanism (URGCAM). The December 31 forecasted balance of the URGCAM would be incorporated in the URG cost forecast filed on October 1 of each year. SDG&E states that the Commission's previous ECAC mechanism is a model for this mechanism. SDG&E explains that each year's forecasted URG revenue requirement would be adjusted to include the under- or over-collected amount from the prior year, and an adjustment would be made to the forecasted rate in order to amortize that under- or over-collected amount.

For purposes of an interim URG ratemaking mechanism, it is reasonable to use a regulatory technique that we have used in the past, *i.e.*, the ECAC mechanism.[6] A balancing account mechanism with provision for amortization of under- and over-collected amounts on an annual cycle is consistent with the objective of financing undercollections on reasonable credit terms.

4.6 Reasonableness Review

Under SDG&E's proposal, the costs of all URG in existence as of the date of SDG&E's motion, *i.e.*, July 16, 2001, and ISO costs and costs for ancillary

[6] We note, however, that the former ECAC mechanism provided for cost recovery limited to certain categories of costs, generally, fuel and purchased power contract expenses. SDG&E has not proposed to similarly limit the scope of its URG cost recovery mechanism, which therefore would include broader categories of generation costs such as capital additions, operations and maintenance expenses, and administrative and general expenses. Consistent with our historical practice, we intend to exclude such URG costs from balancing account treatment, except to the extent such balancing account treatment may be approved by the Commission in the URG phase of A.00-11-038, et al. SDG&E's forecast application should clarify which URG costs would be accorded balancing account treatment consistent with this intent.

service incurred at any time, would be deemed *per se* reasonable, and no reasonableness reviews would be required or allowed for any of those costs.

As ORA has pointed out, SDG&E's proposal for reasonableness reviews is unclear as to scope. Among other things, we are uncertain as to whether SDG&E is proposing that all past, current, and future costs for URG in existence as of July 16, 2001 would be exempt from reasonableness review, or that URG costs as of July 16 would be exempt.

As a matter of regulatory policy, we are not persuaded on the basis of this limited record to forgo reasonableness reviews in connection with SDG&E's proposal for recorded cost ratemaking. SDG&E states that it seeks approval of a cost recovery mechanism that is in accordance with the principles of cost-based ratemaking as applied in California, but it fails to explain how an exemption from reasonableness review comports with those principles. As the Commission stated in D.96-12-088, in the Electric Restructuring proceeding, as long as fuel procurement practices are undertaken in a regulated regime, reasonableness reviews would be the *quid pro quo* of balancing account treatment.[7] (70 CPUC 2d 497, 517.) The record before us today provides us with no basis for concluding that provision for reasonableness review is inconsistent with the objectives for the interim cost recovery mechanism. We note that the MOU itself states that nothing therein "shall prohibit the [Commission] from employing ratemaking and regulatory techniques, methods and standards that have been historically

[7] *See also* D.97-12-096, p. 24, in which the Commission adopted a ratemaking mechanism for PG&E's hydroelectric and geothermal generation: "We continue to believe that reasonableness reviews are the *quid pro quo* of balancing account treatment, even if the balancing account in question has a new name or serves a somewhat different function." (77 CPUC 2d 738, 751.)

used and may be used or implemented in the regulation of public utilities." (MOU, p. 2.)

Upon expiration of the interim mechanism, which as indicated earlier we intend will be not later than December 31, 2002, SDG&E should file an application for review of the reasonableness of its URG costs for the effective period of the interim mechanism.

We recognize that traditional after-the-fact reasonableness reviews are often difficult and contested proceedings. We have found that utilities seeking to be excused from reasonableness reviews (and the associated risk of disallowance of expenses found to be unreasonably incurred) object to the fact that in such proceedings, their adversaries bring known, historical information to the analysis of actions that management undertook in real time in reliance on forecasts. Utilities claim that being held accountable for the reasonableness of their actions on the basis of "20/20 hindsight" is unfair to them and to their shareholders. There is also a broader concern that balancing account ratemaking combined with retrospective reasonableness reviews creates inappropriate incentives for utility managers to perform in ways that may not promote regulatory objectives.

Based upon such concerns, in the past decade we have sought alternative forms of ratemaking that do not require this type of proceeding. For example, nine years ago SDG&E applied for approval of a form of incentive regulation that would, among other things, eliminate traditional reasonableness reviews for gas procurement and electric generation and dispatch. In conditionally approving SDG&E's request, the Commission observed the following with respect to the then-existing ECAC mechanism:

> "Under the Commission's current regulatory program, SDG&E receives balancing account treatment for all generation, dispatch and purchased power costs

> reviewed during the ECAC proceeding. These include fuel and fuel-related costs for electric operations. 'Balancing account treatment' means in essence that SDG&E's actual expenses are recorded, and any overcollections or undercollections resulting from differences between billed amounts and actual expenses are reflected in rates, subject to reasonableness review. [Footnote omitted.]"
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> "A long-standing criticism of balancing accounts and their correlative reasonableness reviews is that they do not provide the utility with any positive incentive to control costs subject to such treatment. The utility has only a negative incentive, viz., to perform in a manner that minimizes the potential for disallowance." (D.93-06-092; 50 CPUC 2d 185, 192.)

After making these observations, the Commission approved a generation and dispatch ratemaking mechanism that limited the scope of reasonableness reviews for SDG&E. It did so by providing for review of ECAC costs when recorded costs varied from the forecast by more than 6%. It also provided for "reasonableness assessment letters" in connection with power purchases from QFs and uranium procurement. (*Id.*, 198.)

While we do not suggest that the 1993 experiment for SDG&E's generation and dispatch be simply replicated here, we call this matter to SDG&E's attention with the expectation that the company will draw upon lessons learned from the experiment, and that it will recognize the types of concerns we would need to address before doing away with reasonableness reviews connected with balancing account treatment. As was true in 1993, any departure from the established policy of requiring reasonableness reviews in connection with recorded cost ratemaking should be accompanied by a weighing

and balancing of the risks to utilities and their customers that are associated with such departure.[8]

4.7 Rate Adjustment Trigger

SDG&E proposes that if the amount in the URGCAM in any month exceeds $75 million in either under- or over-collections, it would adjust rates the following month to reduce the balance to zero over a 12-month amortization.

This proposal raises important questions regarding ratemaking policy that are not appropriately answered at this time. SDG&E essentially asks that we pre-approve future rate increases of unspecified magnitude that SDG&E would be authorized to unilaterally implement in response to an undercollection of $75 million or more in any month. We will not approve such an automatic trigger in connection with the interim URG cost recovery mechanism adopted today.

5. Draft Decision

Rule 77.7 (f)(a) of the Rules of Practice and Procedure provides that the Commission may reduce or waive the 30-day period for public review and comment where it determines that public necessity requires such reduction or

[8] SDG&E commits to operate all URG subject to its control in accordance with good utility practices. We do not consider this commitment by SDG&E to be an adequate replacement for reasonableness review. We are confident that SDG&E is capable of developing a proposal that merits our consideration. In this respect, we agree with SDG&E's assertion in its May 21, 2001 response to a motion by Southern California Edison Company in R.94-04-031, *et al.* regarding procurement:" . . . [T]he Commission and SDG&E already have a strong background in developing creative approaches to regulatory oversight of electric procurement activities. As for back as 1993, the Commission established the first electric generation [ratemaking mechanism] for SDG&E as a way of addressing the inefficiencies and ineffectiveness of reasonableness reviews to accomplish regulatory policy." (Response, p. 5.)

waiver. In connection with this rule, "public necessity" refers to circumstances in which the public interest in adoption of a decision before the 30-day period expires outweighs the public interest in having the full 30-day period for review and comment.

Such circumstances exist in this case. We find that timely implementation of an interim URG recovery mechanism, and setting in motion the process for consideration of a more permanent mechanism as soon as possible, are of critical importance in view of the current uncertainty regarding URG cost recovery. We therefore reduce the 30-day period for review of and comment on the draft decision.

Findings of Fact

1. Pub. Util. Code § 377, as amended by ABX1 6, prohibits the disposition of facilities for the generation of electricity owned by public utilities prior to January 1, 2006, and it requires this Commission to ensure that public utility generation assets remain dedicated to service for the benefit of California ratepayers.

2. The requirement that this Commission shall provide for SDG&E's continued ability to dedicate and operate its URG to ratepayers' benefit in turn requires that the Commission establish an appropriate ratemaking mechanism with respect to SDG&E's URG.

3. There has not been an adequate opportunity in this proceeding for full and fair consideration of SDG&E's proposed URG cost recovery mechanism or possible alternative mechanisms.

4. The objectives of the interim cost recovery mechanism include providing SDG&E with the ability to collect revenues sufficient to recover its reasonable URG costs on a timely basis, in accordance with the principles of cost-based

ratemaking as applied in California; ensuring timely reconciliation of undercollections and overcollections of URG costs; and providing reasonable assurance that any undercollection can be financed in the capital or credit markets on reasonable terms consistent with SDG&E continuing to be an investment grade credit.

5. SDG&E's proposed Utility Retained Generation Cost Adjustment Mechanism (URGCAM) is similar to and based upon the former Energy Cost Adjustment Clause ratemaking mechanism.

6. The Commission has repeatedly adhered to the policy that reasonableness reviews are the *quid pro quo* of balancing account ratemaking treatment.

7. Timely implementation of an interim URG recovery mechanism and setting in motion the process for consideration of a more permanent mechanism as soon as possible are of critical importance in view of the current uncertainty regarding URG cost recovery.

Conclusions of Law

1. This decision addresses only SDG&E's request for establishment of a cost recovery mechanism for URG, and does not consider the SDG&E/Sempra/DWR MOU as a whole.

2. It is appropriate both to provide for full and fair consideration of a URG cost recovery mechanism and to establish an interim URG cost recovery mechanism at this time.

3. For purposes of the interim URG cost recovery mechanism, SDG&E's URG shall consist of the company's interest in SONGS, the SONGS equalization adjustment if approved by the Commission and determined by the Commission to be properly included in the URG mechanism, QF contract costs, Portland General Electric contract costs, other long-term bilateral power purchase contract

costs, ancillary and ISO charges that are not assumed by the DWR, any undercollected amounts recorded in the TCBA that would result if URG costs exceed the 6.5 cents per kWh rate that SDG&E currently charges it customers for URG, and shall exclude two intermediate-term power purchase contracts that expire at the end of 2001, and any options, swaps or other contractual arrangements with third parties relating to the delivery of electricity under said intermediate-term contracts that are entered into in order to change the ultimate point of delivery to South of Path 15 or any other point or points of delivery to which the parties thereto may mutually agree.

4. Any departure from the established policy of requiring reasonableness reviews in connection with recorded cost ratemaking should be accompanied by a weighing and balancing of the risks to utilities and their customers that are associated with such departure.

5. Public necessity requires a reduction of the 30-day period for review of and comment on the draft decision.

6. This order should be effective today.

O R D E R

IT IS ORDERED that:

1. San Diego Gas & Electric Company (SDG&E) is authorized and directed to establish an interim utility-retained generation (URG) cost recovery mechanism as set forth in the foregoing discussion, findings, and conclusions. SDG&E shall file an application setting forth its forecast of URG costs for the 2002 forecast period not later than 15 days after the later of issuance of a Commission decision on its URG costs in the URG phase of Application (A.) 00-11-038, et al., or issuance of a Commission decision on SONGS ratemaking in A.93-12-025, et al.

The application shall include proposal tariff language that would implement the Utility Retained Generation Cost Adjustment Mechanism as authorized herein.

2. Within 60 days of the date of this decision, SDG&E shall file an application for a permanent URG cost recovery mechanism that continues in effect, modifies, or replaces the interim mechanism adopted today.

3. Within 60 days of the date of termination of the interim URG cost recovery mechanism, SDG&E shall file an application for review of the reasonableness of its URG costs for the effective period of the interim mechanism.

4. This proceeding shall remain open.

This order is effective today.

Dated _____, at San Francisco, California.